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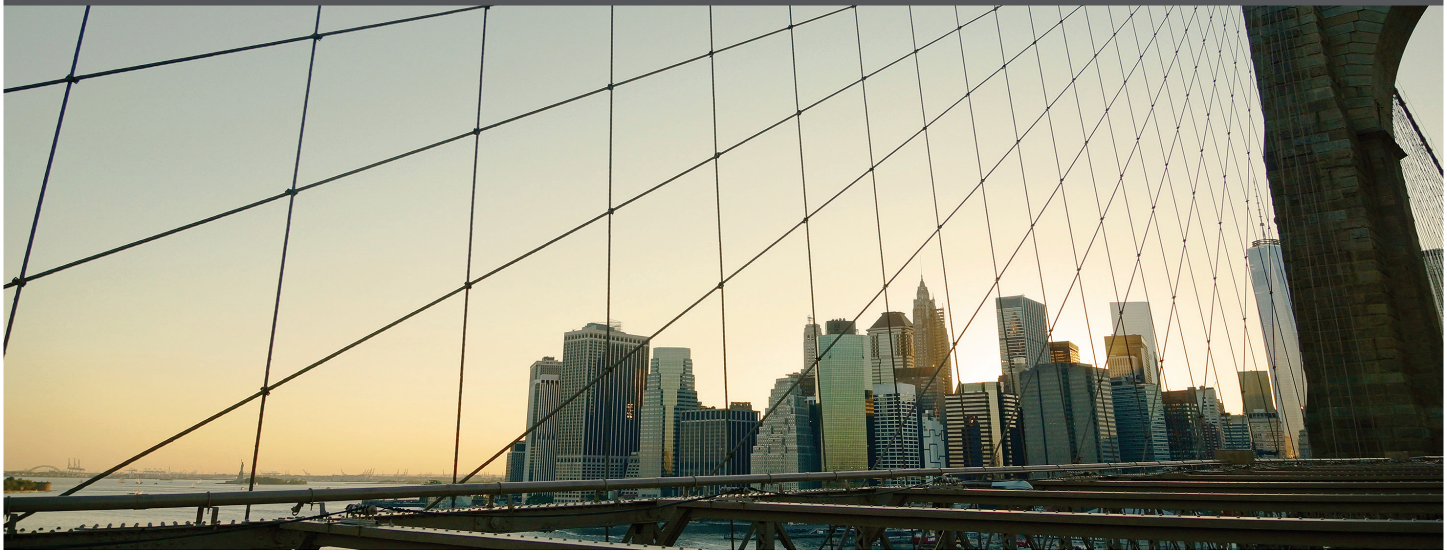
Investment Management



JULY 2023 • NO. 3

Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

Recent SEC Leadership Changes

The Securities and Exchange Commission (the "SEC") announced the appointment of Deborah J. Jeffrey as Inspector General effective May 7, 2023. Prior to this appointment, Ms. Jeffrey served as the Inspector General of AmeriCorps. Before becoming AmeriCorps's Inspector General in 2012, Ms. Jeffrey was in the private practice of law for 25 years and represented individuals and entities in white-collar criminal defense and civil enforcement proceedings (including the Enron cases); defended senior government officials in high-profile criminal, congressional, and Inspector General investigations; and advised lawyers and law firms concerning ethics and risk management. She has also served as Vice Chair of the District of Columbia's attorney disciplinary system.

The SEC announced that Mellissa Campbell Duru was named Deputy Director for Legal and Regulatory Policy in the Division of Corporation Finance on May 19, 2023. Prior to the SEC appointment, Ms. Duru was a Special Counsel at Covington & Burling LLP and previously spent more than 15 years in various SEC roles. At Covington & Burling, Ms. Duru worked in the Securities & Capital Markets practice, advising clients on securities regulation, capital markets transactions, and strategic corporate governance planning. Ms. Duru also served as a Vice Chair of the firm's Environmental, Social, and Governance ("ESG") practice. Ms. Duru served at the SEC from 2004 to 2021, including as a Counsel to then-Commissioner Kara Stein, Special Counsel in the Division of Corporation Finance's Office of Mergers and Acquisitions, and Cybersecurity Legal and Policy Advisor in the Division of Examinations. During her tenure, she also served as an SEC Brookings Institute Legislative Congressional Fellow in the Office of U.S. Senator Jack Reed and began her SEC career in the Division of Corporation Finance's Disclosure Review Program.

SEC RISK ALERTS AND STATEMENTS

Division of Examinations Issues Risk Alert on Examinations of Newly Registered Advisers

On March 27, 2023, the SEC's Division of Examinations ("Division") issued a risk alert ("Risk Alert") summarizing the staff's observations from examinations of newly registered investment advisers ("New Advisers"). The Risk Alert notes that it is a resource for New Advisers in preparing for an SEC examination and discusses the typical areas of focus during such examinations, including whether the firms have: (1) identified and addressed conflicts of interest; (2) provided clients with full and fair disclosure such that clients can provide informed consent; and

(3) adopted effective compliance programs. Per the Risk Alert, staff observations included issues regarding compliance policies and procedures, disclosures, and marketing practices. For example, policies and procedures did not address certain risk areas applicable to the firm such as portfolio management and fee billing or there were no procedures to enforce stated policies. In addition, the Risk Alert includes a list of the type of information that may be requested by the SEC staff in examinations as well as a table of resources. New Advisers or those planning to register, should carefully review the Risk Alert and take the opportunity to review current compliance policies, practices, and disclosures.

Division of Examinations Issues Risk Alert on LIBOR—Transition Preparedness

The Division issued a Risk Alert on May 11, 2023, to "remind firms of the transition" with respect to the cessation of the London Interbank Offered Rate ("LIBOR"), as well as to summarize certain observations from recent sweep examinations to assess the preparedness of investment advisers and investment companies ("firms") for the cessation of LIBOR. LIBOR was scheduled to be discontinued after June 30, 2023.

The types of firms examined included: (i) advisers associated with large bank complexes; (ii) advisers to various types of registered investment companies (*i.e.,* mutual funds, closed-end funds, exchange-traded funds, and business development companies); (iii) small, medium, and large fund complexes; (iv) advisers to private funds that invest in private credit, such as collateralized loan obligations; and (v) large retail-oriented advisers. The staff noted that firms' preparation efforts varied considerably, depending on the type and amount of LIBOR exposure. Most of the firms that the Division staff examined had significant direct exposure to LIBOR-linked contracts, while a few had large retail client bases and more limited and indirect exposure. In its observations, the staff noted certain practices firms have implemented to address the transition from LIBOR in areas such as risk management; operations; portfolio management; fiduciary responsibilities and investor communications; and ongoing and new challenges.

The Division staff observed that some firms were treating the risk related to the LIBOR transition as an enterprise risk governance matter and that firms with significant exposures have formed cross-functional LIBOR transition working groups, often overseen by a risk governance committee, created detailed written transition plans, and completed comprehensive impact assessments. The staff also noted that almost all examined firms are either members of the Alternative Reference Rates Committee ("ARRC") or relied heavily on guidance that ARRC has provided. The staff also observed active engagement with service providers, sub-advisers, and third-party managers and that many firms worked extensively with fund administrators and pricing or data providers to understand their transition readiness and performed extensive systems testing to identify issues to remedy or workarounds needed to process alternative reference rates.

The Division staff also observed that firms have worked to identify LIBOR exposure early and engaged in a substantive review of fallback provisions. Many firms used third-party service providers with specialized skills in document review to identify fallback provisions. Firms proactively assessed risks associated with such provisions, or lack thereof, and prioritized identifying and assessing contracts considered "tough legacy" that may be more challenging to transition. It was noted that some firms have created internal controls such as pre-trade compliance checks or purchasing guidance, and that there was early transitioning of bank loans and other instruments, where practicable, or the urging of counterparties to convert ahead of the LIBOR cessation date.

Fiduciary responsibilities and investor communications was another area discussed in the Risk Alert. It was noted that firms with significant exposures included comprehensive disclosures for risks associated with the transition, such as legal, operational, credit, and regulatory risk. Additionally, firms have implemented a wide range of client communication and engagement strategies, depending on their business and determinations of what information would be meaningful to their clients. Such communication in the case with clients that have greater exposure included more generalized disclosures on their website or in brochures and fund documents. The Division encourages all firms to be aware of these issues, consider resources necessary to address them, and to act consistent with their fiduciary obligations as they continue in the transition process.

Division of Examinations Issues Risk Alert on Expanded Focus on the Adviser Marketing Rule

The Division published a new Risk Alert on June 8, 2023, for investment advisers currently registered or required to be registered with the SEC ("Advisers"), including advisers to private funds, about additional areas of emphasis during examinations focused on amended Rule 206(4)-1 (the "Marketing Rule") under the Advisers Act of 1940 (the "Advisers Act"). The Division had previously published a Risk Alert in September 2022 describing initial areas of review related to examinations for compliance with the Marketing Rule. The new Risk Alert sets forth additional areas of focus, including (1) testimonials and endorsements; (2) third-party ratings; and (3) Form ADV.

SEC Data Breach More Extensive Than Previously Reported

The SEC announced, on June 2, 2023, that the data breach previously reported by the agency with respect to memoranda in connection with certain administrative cases was much more extensive than initially revealed and that the breach may have affected approximately 90 matters.

In April 2022, the SEC first issued a Statement Relating to Certain Administrative Adjudications (the "April 2022 Statement") describing a control deficiency related to the separation of enforcement and adjudicatory functions within the agency's system for administrative adjudication. Per the April 2022 Statement, for a period of time, certain databases maintained by the SEC's Office of the Secretary ("OS") were not configured to restrict access by staff of the SEC's Division of Enforcement ("Enforcement") to memoranda drafted by staff from the Adjudication Group in the SEC's Office of the General Counsel ("Adjudication"). As a result, in a number of adjudicatory matters, administrative support staff from Enforcement responsible for maintaining Enforcement's case files accessed Adjudication memoranda via OS's databases. In many instances, those administrative staff also emailed Adjudication memoranda to other administrative staff for potential upload to Enforcement databases and once uploaded, the memoranda became accessible more broadly to Enforcement staff.

The SEC initially reported at the time that the detected breach affected two cases, one of which has since been decided by the U.S. Supreme Court. However, the SEC's recent June 2, 2023, announcement indicated that further investigation revealed that Enforcement administrative staff accessed one or more Adjudication memoranda specific to a particular matter in 28 other matters, as well as 61 additional matters in which one or more Adjudication memoranda broadly applicable to numerous pending matters were accessed by Enforcement administrative staff. For example, Enforcement attorneys had improper access to privileged documents in the case of *SEC v. Jarkesy* discussed below. See "Government Seeks Supreme Court Review of Fifth Circuit Decision in *SEC v. Jarkesy"* below. In the *Jarkesy* case, the breach was revealed in the initial disclosures and investigators concluded that they did not find evidence of misconduct by Enforcement staff. The June 2023 statement from the SEC also detailed the reporting, investigation and remediation process, which included enhanced access controls to prevent internal Adjudicatory memos from being uploaded to databases used by Enforcement staff and a comprehensive internal review to assess the scope and potential impact of the control deficiency.

"We deeply regret that the agency's internal systems lacked sufficient safeguards surrounding access to Adjudication memoranda, and we are continuing our work to ensure that, going forward, work product from the Adjudication staff is appropriately safeguarded. We take this lapse in controls very seriously and are committed to both informing the public about the scope of this issue and preventing any similar lapses in the future," said an SEC representative in a statement.

SEC RULEMAKING

SEC Reopens Comment Period for Proposed Amendments to Exchange Act Rule 3b-16 and Provides Supplemental Information

On April 14, 2023, the SEC again reopened the comment period and provided supplemental information on proposed amendments to the definition of "exchange" under the Securities Exchange Act of 1934 (the "Exchange Act") Rule 3b-16. The SEC initially proposed the amendments in January 2022 and reopened the comment period in May 2022. The initial reopened comment period closed on June 13, 2022. The reopening release reiterated the applicability of existing rules to platforms that trade crypto asset securities, including so-called "DeFi" systems, and provided supplemental information and economic analysis for systems that would be included in the proposed exchange definition. The release also requested information and public comment on crypto asset securities trading on such systems and certain aspects of the proposed amendments applicable to all securities. Firms such as the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG") provided comments to the SEC noting that the proposed amendments "suggests a dramatic expansion of regulatory scope and obligations in ways unrelated to a data-driven identification of problems requiring attention." Commentators suggested that the proposed amendments need further clarification and that order execution management systems as well as exchange-traded fund portals should be explicitly carved out from treatment as an "exchange." The public comment period remained open for 30 days after publication of the reopening release in the Federal Register.

"I believe this supplemental release will help address comments on the proposal from various market participants, particularly those in the crypto markets," said SEC Chair Gary Gensler. "Make no mistake: many crypto trading platforms already come under the current definition of an exchange and thus have an existing duty to comply with the securities laws. Investors in the crypto markets must receive the same time-tested protections that the securities laws provide in all other markets. I welcome additional public comment on all aspects of the proposal in light of the information in this supplemental release."

SEC Reopens Comment Period for Proposed Rule Amendments to Modernize Beneficial Ownership Reporting

The SEC proposed amendments (the "Proposed Amendments") to the rules governing beneficial ownership reporting under Sections 13(d) and (g) of the Exchange Act in February 2022. On April 28, 2023, the SEC reopened the comment period for its Proposed Amendments to modernize the rules governing beneficial ownership reporting, and the staff of the SEC's Division of Economic and Risk Analysis released a memorandum that provided supplemental data and analysis related to the Proposed Amendments' economic effects. The Proposed Amendments would: (i) modernize the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G; (ii) deem holders of certain cash settled derivative securities as beneficial owners of the reference equity securities and clarify the disclosure requirements of Schedule 13D with respect to derivative securities; (iii) clarify and affirm the operation of the beneficial ownership reporting rules as applied to two or more persons that form a group under the Exchange Act, and provide new exemptions to permit such persons to communicate and consult with each other, jointly engage issuers, and execute certain transactions without being subject to regulation as a group; and (iv) require that Schedules 13D and 13G be filed using a structured, machine-readable data language. The public comment period will remain open until June 27, 2023, or until 30 days after the date of publication of the reopening release in the Federal Register, whichever is later.

SEC Adopts Amendments to Modernize Share Repurchase Disclosure

The SEC adopted amendments on May 3, 2023, to modernize the disclosure requirements relating to repurchases of an issuer's equity securities, including requiring issuers to provide daily repurchase activity on a quarterly or semi-annual basis, depending on the type of issuer. The staff states that the amendments will improve disclosure and provide investors with enhanced information to assess the purposes and effects of share repurchases.

The adopted amendments will:

(1) require issuers to disclose daily quantitative share repurchase information either quarterly or semi-annually. The required disclosures include, for each day on which a repurchase was conducted, the number of shares repurchased that day and the average price paid, among other things;

(2) require issuers to include a checkbox indicating whether certain officers and directors traded in the relevant securities in the four business days before or after the announcement of the repurchase plan or program;

(3) revise and expand narrative repurchase disclosure requirements to require that an issuer disclose: (i) the objectives or rationales for its share repurchases and the process or criteria used to determine the amount of repurchases; and (ii) any policies and procedures relating to purchases and sales of the issuer's securities during a repurchase

program by its officers and directors, including any restriction on such transactions; and

(4) add a new item to Regulation S-K requiring disclosure on how issuers use Rule 10b5-1 plans. New Item 408(d) will require quarterly disclosure in periodic reports on Forms 10-Q and 10-K about an issuer's adoption and termination of Rule 10b5-1 trading arrangements.

Foreign private issuers that file on foreign private issuer forms are required to disclose the quantitative data in new Form F-SR beginning with the Form F-SR that covers the first full fiscal quarter that begins on or after April 1, 2024, and provide the narrative disclosure starting in the first Form 20-F filed after their first Form F-SR has been filed. Registered closed-end management investment companies that are exchange traded are required to disclose the quantitative data and provide the narrative disclosure on Form N-CSR beginning with the Form N-CSR that covers the first six-month period that begins on or after January 1, 2024. All other issuers will be required to include the quantitative data as an exhibit to their Forms 10-Q and 10-K and provide the narrative disclosure in their Forms 10-Q and 10-K beginning with the first filing that covers the first full fiscal quarter that begins on or after October 1, 2023.

"In 2021, buybacks amounted to nearly $950 billion and reportedly reached more than $1.25 trillion in 2022," said SEC Chair Gary Gensler. "Today's amendments will increase the transparency and integrity of this significant means by which issuers transact in their own securities. Through these disclosures, investors will be able to better assess issuer buyback programs. The disclosures will also help lessen some of the information asymmetries inherent between issuers and investors in buybacks. That's good for investors, issuers, and the markets."

SEC Adopts Amendments to Form PF to Enhance Private Fund Reporting

On May 3, 2023, the SEC adopted amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds. Per the adopting release, the amendments are designed to enhance the ability of the Financial Stability Oversight Council ("FSOC") to assess systemic risk and to bolster the SEC's oversight of private fund advisers and its investor protection efforts. The amendments will require large hedge fund advisers and all private equity fund advisers to file current reports upon the occurrence of certain reporting events that could indicate significant stress at a fund or investor harm. Reporting events for large hedge fund advisers include certain extraordinary investment losses, significant margin and default events, terminations or material restrictions of prime broker relationships, operations events, and events associated with withdrawals and redemptions. The amendments require that large hedge fund advisers must file these reports as soon as practicable but not later than 72 hours from the occurrence of the relevant event. Reporting events for private equity fund advisers include the removal of a general partner, certain fund termination events, and the occurrence of an adviser-led secondary transaction. Private equity fund advisers must file these reports on a quarterly basis within 60 days of the fiscal quarter end.

The amendments will also require large private equity fund advisers to report information on general partner and limited partner clawbacks on an annual basis as well as additional information on their strategies and borrowings as a part of their annual filing. The amendments for current reporting will become effective six months after publication of the adopting release in the Federal Register, and the remaining amendments will become effective one year after publication in the Federal Register.

"In the 12 years since the Commission first adopted Form PF, private funds have evolved significantly in their business practices, complexity, and investment strategies," said SEC Chair Gary Gensler. "Private funds today are ever more interconnected with our broader capital markets. They also nearly have tripled in size in the last decade. This makes visibility into these funds ever more important. Today's amendments to Form PF will enhance visibility into private funds and help protect investors and promote financial stability."

SEC Releases Rulemaking Spring 2023 Agenda

The Office of Information and Regulatory Affairs released the Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions (the "Agenda"). The Agenda, published on June 13, 2023, identifies the short- and long-term regulatory actions that the SEC expects to issue in proposed or final form and the broad targeted time frame to issue such proposed and final rules. As compared with the last two published versions of the SEC's regulatory agenda, the most recent Agenda has a larger number of rules in the final rule stage—37 in total versus 18 in the proposed rule stage—suggesting that the SEC may be generally shifting its emphasis from proposing additional rules to taking final action on previously proposed rules.

The SEC set action dates with respect to proposed and final rules by October 2023 or April 2024. The time period for actual rule adoption or proposal may vary and, therefore, may not be released on the listed dates. The SEC has extended the anticipated timing by six months to October 2023 for finalizing certain of its proposed rules, including those relating to climate change disclosure; cybersecurity risk governance; and modernization of beneficial ownership reporting. Certain items on the Agenda have already been issued, such as amendments to Form PF and money market fund reforms (see "SEC Adopts Amendments to Form PF to Enhance Private Fund Reporting" and "SEC Adopts Money Market Fund Reform Rules" in this update.)

Following is a summary of the status of certain relevant Agenda items:

Previously Announced Anticipated Rulemaking (Proposed Rule Stage)

Action Date for Issuance of Rule Proposal (or reproposal): by April 2024

- Corporate Board Diversity (disclosures to enhance registrant disclosures about the diversity of board members and nominees)
- Regulation SP: Privacy of Consumer Financial Information and Safeguarding Customer Information
- Outsourcing by Investment Advisers

New Anticipated Rulemaking

Action Date for Issuance of Rule Proposal: by April 2024

- Fund Fee Disclosure and Reform (proposing changes to regulatory requirements relating to registered investment companies' fees and fee disclosure)

Previously Proposed Rules (Final Rule Stage)

Action Date for Adoption of Final Rule: by October 2023

- Climate Change Disclosure (rules to enhance climate-related disclosures for issuers and investment advisers)
- Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (changes to requirements relating to open-end fund liquidity and dilution management)
- Private Funds Rule (targeting private equity and other private funds to significantly expand the disclosure of standardized fee and expense information and require registered private fund advisers to obtain an annual audit for each private fund advised)
- Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies
- Rule 14a-8 Amendments (amendments to exclusions of shareholder proposals under Rule 14a-8 of the Exchange Act)
- Investment Company Names (amendments to rule 35d-1 of the Investment Company Act of 1940, as amended (the "Investment Company Act") and enhanced prospectus disclosure requirements for terminology used in fund names, and additional requirements for funds to report information on Form N-PORT regarding compliance with the proposed names-related regulatory requirements)
- Enhanced Disclosures by Certain Investment Advisers and Investment Companies about ESG Investment Practices
- Modernization of Beneficial Ownership Reporting
- Loan or Borrowing of Securities
- Safeguarding Advisory Client Assets

"Taken together, the items on this agenda would advance our three-part mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," said SEC Chair Gary Gensler.

SEC Reopens Comment Period for Position Reporting of Large Security-Based Swap Positions

The SEC reopened the comment period for its new rule proposal, Position Reporting of Large Security-Based Swap Positions (the "Proposing Release"), initially released on June 20, 2023. The proposed rule would require any person with a security-based swap position that exceeds a certain threshold to promptly file with the SEC a schedule disclosing certain information related to its security-based swap position. Per the Proposing Release, the comment period was reopened to allow interested persons an opportunity to comment on the additional analysis and data contained in the SEC Division of Economic and Risk Analysis' staff memorandum that was added to the public comment file on June 20, 2023.

SEC Adopts Money Market Fund Reform Rules

On July 12, 2023, the SEC adopted amendments to certain rules that govern money market funds under the Investment Company Act. The amendments will increase minimum daily and weekly liquidity requirements for all money market funds. The amendments will also remove provisions in the current rule that permit a money market fund to suspend redemptions temporarily through a gate and allow money market funds to impose liquidity fees if their weekly liquid assets fall below a certain threshold. The amendments will also require institutional prime and institutional tax-exempt money funds to impose mandatory liquidity fees when a fund is in daily net redemptions that surpass 5 percent of net assets, unless the liquidity costs are de minimis, and require any non-government money market fund to impose a discretionary liquidity fee if the board determines that a fee is in the best interest of the fund. Separately, the amendments will also modify certain reporting forms that are applicable to money market funds and large private liquidity fund advisers. The rule amendments will become effective 60 days after publication in the Federal Register with a tiered transition period for funds to comply with the amendments. The reporting form amendments will become effective June 11, 2024.

SEC ENFORCEMENT ACTIONS

Government Seeks Supreme Court Review of Fifth Circuit Decision in *SEC v. Jarkesy*

The SEC brought an administrative proceeding against George Jarkesy and his advisory firm, Patriot28 (the "Firm") on March 22, 2013, alleging violations of the Securities Act of 1933 (the "Securities Act"), the Exchange Act, and the Advisers Act in connection with their alleged mismanagement of two hedge funds. Jarkesy sued the SEC alleging various constitutional violations arguing that SEC fraud charges against him be prosecuted in federal court.

The *Jarkesy* case raises the central question of the constitutional basis for the SEC's administrative court process. The Fifth Circuit agreed with Jarkesy and ruled that: (1) the SEC deprived Jarkesy the constitutional right to a jury trial; (2) the SEC's discretion in exercising the option to bring enforcement actions administratively instead of in federal district courts is unconstitutional; and (3) statutory removal restrictions insulating SEC administrative law judges are unconstitutional. The Fifth Circuit Court also ruled that firms and individuals may challenge the constitutionality of SEC enforcement actions in federal court. The SEC appealed the Fifth Circuit decision in March 2023 and the Supreme Court granted certiorari, granting review of the *SEC v. Jarkesy* case.

In a similar case, the Supreme Court, in a unanimous decision, sided with the plaintiff, Michelle Cochran, who argued that the SEC's administrative law judges are unconstitutionally protected from federal court oversight because the executive branch judges are selected by the SEC and Federal Trade Commission ("FTC") rather than the President. Cochran's case will return to the lower courts, where she will be able to pursue litigation against the SEC in *SEC v. Cochran.*

SEC Charges Chatham Asset Management and Founder for Improper Fixed Income Securities Trading

The SEC charged New Jersey-based Chatham Asset Management LLC and its founder, Anthony Melchiorre, in connection with improper trading of certain fixed income securities on April 3, 2023. The SEC's order found that, from 2016 through 2018, one Chatham-advised client sold a leading media company's bonds while a different Chatham-advised client purchased the same bonds through various broker-dealers. Per the SEC's order, Chatham engaged in these trades to address portfolio constraints such as industry or issuer fund concentration limits, meet investor redemptions, and allocate capital inflows and outflows. The SEC's order further found that these trades were executed at prices Chatham and Melchiorre proposed and had the effect of increasing the price of the bonds at a significantly higher rate than the prices of similar securities. Chatham's and Melchiorre's trading in the bonds accounted for the vast majority of trading in those securities and, therefore, over time had a material effect on their pricing.

The SEC's order also found that Chatham and Melchiorre calculated the net asset values, or NAVs, of their client funds' holdings using pricing data that was based, in part, on the trading prices of the securities. As a result, during the relevant period, the NAVs of Chatham's clients were higher than they would have been if the subject trades were removed from the market for the bonds, which, in turn, resulted in higher fees being charged to the clients. Chatham and Melchiorre consented to the SEC's order, without admitting or denying its findings, that they violated Section 206(2) of the Advisers Act and that they aided and abetted and caused violations of the Investment Company Act. Chatham and Melchiorre agreed jointly and severally to pay $11 million in disgorgement and around $3.4 million in prejudgment interest. They also agreed to pay civil penalties of $4.4 million and $600,000, respectively, and to prohibitions from serving in certain positions in the investment industry.

SEC Charges Investment Adviser for Failing to Disclose Foreign Exchange Fees to Clients

The SEC charged an investment adviser and broker-dealer (the "Firm") for charging advisory clients more than $4 million in undisclosed foreign exchange fees for transfers to or from their accounts. The SEC's order, issued on April 3, 2023, found that between May 2016 and July 2020, the Firm offered programs to advisory clients in which the clients paid a fee in exchange for a range of investment advisory services, including foreign currency exchanges. In the program's client agreements and brochures, the Firm disclosed that it charged a markup or markdown on foreign currency exchanges, but it did not disclose an additional fee it referred to as a production credit, which, in more than 80 percent of the transactions, was equal to or greater than the disclosed markup or markdown. The Firm paid a percentage of these production credits to its financial advisors and referred to this charge as a commission in internal documents.

The SEC's order also found that the Firm failed to adopt and implement policies and procedures reasonably designed to prevent its disclosures from being misleading about the fees it charged on foreign currency exchanges. The Firm consented to the entry of the SEC's order finding that it violated Sections 206(2) and 206(4) of the Advisers Act and related rules. Without admitting or denying the SEC's findings, the Firm agreed to a cease-and-desist order, a censure, and to pay disgorgement of approximately $4.1 million, prejudgment interest thereon of $760,000, and a civil penalty of $4.8 million. The Firm agreed to distribute funds to harmed advisory clients.

SEC Charges Investment Adviser for Misstatements Concerning Tax Loss Harvesting Service

The SEC charged investment advisory firm, Betterment LLC ("Betterment"), for material misstatements and omissions related to its automated tax loss harvesting service ("TLH"), for failing to provide clients with notice of changes to contracts, and for failing to maintain certain required books and records. The SEC's April 18, 2023, order found that, from 2016 to 2019, Betterment, in communicating with clients, misstated or omitted several material facts concerning TLH, a service that scans clients' accounts for opportunities to reduce their tax burden. According to the order, Betterment on difference occasions failed to disclose a change in the software related to its scanning frequency and a programming constraint affecting certain clients and also had two computer coding errors that prevented TLH from harvesting losses for some clients. Collectively, these issues adversely impacted more than 25,000 client accounts, resulting in those clients losing approximately $4 million in potential tax benefits.

The SEC's order also found that Betterment failed to provide advance notice of changes to its advisory contract, which is a violation of its fiduciary duty as an investment adviser, and failed, during certain times, to maintain accurate and current books and records reflecting written agreements with certain clients. Also, the order found that Betterment failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act. Betterment consented to the entry of the SEC's order finding that it violated Sections 204, 206(2), and 206(4) of the Advisers Act and related rules. Without admitting or denying the

SEC's findings, Betterment agreed to a cease-and-desist order, a censure, and to pay a $9 million civil penalty that will be distributed to affected clients.

U.S. Chamber of Commerce Challenges SEC Proxy Firm Rules in Sixth Circuit Appeal

The SEC announced its adoption of final amendments to rules governing proxy voting advice in October 2022. Since the adoption of these amendments, there has been ongoing litigation. On April 24, 2023, U.S. District Judge Aleta A. Trauger in Tennessee granted the SEC's cross-motion for summary judgment in a suit seeking to nullify the SEC's rule reversals governing proxy advisory firms brought by the U.S. Chamber of Commerce (the "Chamber of Commerce"), the Business Roundtable, and the Tennessee Chamber of Commerce & Industry. This judgment comes months after a Texas federal judge dismissed a similar case against the SEC.

In July 2020, the SEC adopted rules that added conditions in Exchange Act Rule 14a-2(b)(9)(ii)(A) and (B) requiring a proxy voting advice business ("PVAB") to adopt and publicly disclose written policies and procedures reasonably designed to ensure "notice-and-awareness" conditions. In July 2022, the SEC rescinded certain aspects of the proxy voting advice rules and relaxed the 2020 restrictions on proxy firms such as Institutional Shareholder Services Inc. and Glass, Lewis & Co., which drew lawsuits led by the Chamber of Commerce and National Association of Manufacturers. The organizations filed suit in July 2022 alleging that the SEC overstepped when it rescinded certain proxy advisory rules enacted during the Trump administration. The SEC claimed that the updated Trump-era rules favored companies and that reversing certain elements of the 2020 rules would have made it harder for investors to obtain timely and impartial recommendations on voting matters.

The SEC also argued that the 2020 rules would have required proxy firms to inform companies of their voting recommendations by at least the same time as they inform their clients, and that proxy firms notify clients of companies' written responses to such advice. The SEC concluded that companies have ample means to communicate their views to shareholders without imposing new rules on the proxy advisory process. The District Court rejected the industry groups' argument and said that the SEC's argument had sufficient merit that the rule reversal was preferable and granted the SEC's motion, that the SEC "fully identified and explained the concerns on both sides of the issue and set forth its conclusion regarding which was more persuasive." On May 3, 2023, the Chamber of Commerce and other business groups appealed the SEC court victory, and the U.S. Court of Appeals for the Sixth Circuit is now expected to issue a ruling on appeal.

SEC Charges Advisory Firm and Part-Owner for Breach of Fiduciary Duty in Connection with Use of Leveraged ETFs

The SEC announced that it settled charges against Fargo, North Dakota-based investment adviser Classic Asset Management LLC ("CAM") and indirect part-owner and investment adviser representative Douglas G. Schmitz ("respondents"), for breach of fiduciary duty in connection with the use of leveraged exchange-traded funds ("ETFs") in discretionary client accounts. According to the SEC's order, issued on May 4, 2023, from at least 2017 through December 2020, CAM and Schmitz invested advisory clients in leveraged ETFs for extended periods of time, often in significant concentrations, despite warnings in the funds' prospectuses that the products carried unique risks, were designed to be held for no more than a single trading day, and required frequent monitoring.

The order found that CAM and Schmitz misunderstood these fundamental characteristics of leveraged ETFs and thus lacked a reasonable belief that the leveraged ETFs were in their clients' best interests. The order states that neither CAM nor Schmitz had a reasonable basis to conclude that the leveraged ETFs were suitable for their clients either generally or in the manner in which they intended to use them and that despite the language in the prospectuses, respondents did not fully appreciate the leveraged ETFs' most consequential attributes, including that the leveraged ETFs were designed as short-term trading tools and that there were material risks to holding the ETFs in significant amounts for periods considerably longer than recommended by the issuers.

Further, according to the order, CAM and Schmitz failed to appropriately monitor the performance of these products and, consequently, did not evaluate whether the leveraged ETFs were in their clients' best interests throughout the holding period. The order also found that CAM failed to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act. The SEC's order further found that CAM and Schmitz violated the Advisers Act and that CAM also violated the compliance provision of the Advisers Act. CAM and Schmitz agreed, without admitting or denying the SEC's findings, to a cease-and-desist order and censures and to pay $195,228 and $738,113, respectively, in disgorgement, prejudgment interest, and civil penalties. CAM also agreed to conduct a respondent-administered distribution.

SEC Charges Investment Adviser and Fund Trustees with Liquidity Rule Violations

On May 5, 2023, the SEC charged an investment adviser (the "Company") for aiding and abetting violations of the rules relating to liquidity risk management (the "Liquidity Rule") by an open-end investment company (the "Fund") that it advised and whose liquidity risk management program ("LRMP") pursuant to the Rule that it administered. The SEC claimed that the Fund failed to comply with Rules 22e-4 and 30b1-10 under the Investment Company Act. In addition to the Company, the SEC also charged the Fund's two independent trustees and two officers of both the Company and of the Fund it advised, (collectively, the "Officers"), with aiding and abetting Liquidity Rule violations by the Fund. A third trustee, Joseph Masella, formerly an interested trustee on the Fund's board of trustees (the "Board"), agreed to settle charges that he caused and willfully counseled the Fund's violations.

The action is the first-ever case enforcing the Liquidity Rule. Rule 22e-4 prohibits mutual funds from investing more than 15 percent of their net assets in illiquid investments, requires funds to take certain prompt remedial steps if they hold illiquid investments above this percentage limit, and requires them to adopt a liquidity risk management program to assess funds' liquidity risk.

The SEC's complaint alleged that, from June 2019 to June 2020, the Fund held approximately 21 to 26 percent of its net assets in illiquid investments. According to the complaint, the Company and its Officers classified the Fund's largest illiquid investment as a "less liquid" investment, ignoring restrictions, transfer limitations, and the absence of any market for the shares, and disregarding the advice of Fund counsel and auditors. The SEC alleged that the Company and its Officers did not present the Fund's Board with a plan to reduce the Fund's illiquid investments to 15 percent or lower or make required filings with the SEC, as required by the Liquidity Rule. The complaint also stated that the Officers and Masella misled the SEC's Division of Investment Management about the basis for the Fund's liquidity classifications.

In addition, the complaint alleged that the Fund's Board, including the independent trustees, did not meet its own oversight responsibilities regarding the Fund's compliance with the Liquidity Rule. The complaint charges that the independent trustees aided and abetted the Fund's violations by recklessly failing to exercise reasonable oversight of the Fund's program as required by the Liquidity Rule because they were "keenly aware" of the facts that rendered the shares illiquid—from information they learned as members of the Valuation and Audit Committees—as well as from advice from the Fund's counsel and auditors, yet allowed the shares to be improperly classified as a "less illiquid" investment instead of as an "illiquid investment."

The SEC's complaint seeks permanent injunctions and civil money penalties. The Fund is now a liquidating trust and was not separately charged. Without admitting or denying the SEC's findings, Masella consented to an order requiring him to cease-and-desist from violations of the Liquidity Rule and pay a civil penalty of $20,000, and suspended him from association with any investment adviser, registered investment company, and others for six months.

The SEC also charged another investment adviser (the "Firm"), an affiliate of the Company, for making false and misleading statements in its Form ADV brochure regarding reviews of advisory client accounts and failing to disclose certain conflicts of interests, failing to adopt and implement related policies and procedures, and deliver to clients required information about advisory personnel. Without admitting or denying the SEC's findings, the Firm consented to an order requiring it to cease-and-desist from violations of the antifraud and other provisions of the Advisers Act, a censure, and disgorgement and a civil penalty totaling approximately $476,000.

SEC Files 13 Charges Against Binance Entities and Founder and Seeks Emergency Relief for Customer Assets

On June 5, 2023, the SEC charged Binance Holdings Ltd. ("Binance"), operator of the largest crypto asset trading platform in the world, Binance.com; its U.S.-based affiliate, BAM Trading Services Inc. ("BAM Trading"), which, together with Binance, operates the crypto asset trading platform, Binance.US; and their founder ("Founder") with a variety of securities law violations. Among other allegations, the SEC alleged that: (i) Binance and its Founder publicly claimed that U.S. customers were restricted from transacting on Binance.com while secretly allowing high-value U.S. customers to continue trading on the Binance.com platform; (ii) publicly claimed that Binance.US was created as a separate, independent trading platform for U.S. investors while secretly controlling the Binance.US platform's operations; (iii) permitted the commingling of customer assets or the diversion of customer assets to an entity the Founder owned and controlled called Sigma Chain; (iv) misled investors about non-existent trading controls over the Binance.US platform, while Sigma Chain engaged in manipulative trading that artificially inflated the platform's trading volume; and (v) concealed the fact that billions of dollars of investor assets were co-mingled and sent to a third party, Merit Peak Limited, also owned by the Founder.

The complaint also charged various violations of registration-related provisions of federal securities laws, including operating unregistered national securities exchanges, broker-dealers, and clearing agencies.

Subsequent to the above-mentioned complaint, the SEC filed an emergency action seeking a temporary restraining order against the defendants to, among other emergency relief, freeze assets and direct defendants to repatriate assets held for the benefit of customers of the Binance.US crypto trading platform in order to ensure that Binance.US customers' assets are protected and remain in the United States through the resolution of the SEC's pending litigation of this matter. An order was granted by the U.S. District Court for the District of Columbia on June 17, 2023.

SEC Charges Investment Adviser and Principal in Abusive Naked Short Selling Scheme

The SEC charged investment adviser Sabby Management LLC ("Sabby") and its managing partner, Hal D. Mintz ("Mintz"), with fraud in connection with a long running scheme involving misrepresentations and violations of rules for short selling and order making, as well as other violative trading, which generated more than $2 million in illegal profits. The SEC's complaint filed on June 12, 2023, alleged that, from at least March 2017 through May 2019, Sabby and Mintz repeatedly circumvented trading rules to conduct unlawful trades in the stock of at least 10 public companies. Short selling is a legal practice where a trader borrows a security from a securityholder and sells the security at one price, speculating that the trader can buy the security at a lower price in the future before it must be returned to its owner. As alleged in the complaint, Sabby and Mintz engaged in illegal "naked short selling" by intentionally and improperly placing short sales when they knew or were reckless in not knowing that they had not borrowed or located the shares, and then failed to make timely delivery of the shares.

According to the SEC's complaint, the purpose of Sabby and Mintz's fraudulent scheme was to earn profits they could not have gained through legal trading. Additionally, the complaint alleged, on occasion Sabby and Mintz used their naked short selling to artificially deflate the price of securities, allowing them to obtain more shares at a cheaper price, and that Sabby and Mintz tried to conceal their fraudulent trading, including by using securities acquired after the trades, to make it appear to brokers executing the trades that they had complied with the requirement to have borrowed or located the shares prior to their trades. The complaint also alleged, when questioned by at least one broker regarding their trading, Sabby and Mintz repeatedly lied about the trading.

The SEC's complaint, filed in the U.S. District Court for the District of New Jersey, charged Sabby and Mintz with violations of Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder. The complaint also charged Sabby with violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2 and 206(4)-7 thereunder and charged Mintz with aiding and abetting those violations. The complaint sought permanent injunctive relief, disgorgement of ill-gotten gains plus prejudgment interest, and civil penalties.

SEC Charges an Investment Adviser for Disclosure and Policies and Procedures Failures

The SEC announced on June 16, 2023, that a registered investment adviser (the "Company") will pay $9 million to settle two enforcement actions relating to disclosure and policies and procedures violations involving two funds it advises. In the first action, the SEC found that, from September 2014 to August 2016, the Company failed to disclose material information regarding one of its funds to investors concerning the use of interest rate swaps and the material impact of the swaps on the fund's dividend. In the second action, the SEC found that, from April 2011 to November 2017, the Company failed to waive approximately $27 million of advisory fees as required by its agreement with another fund. Additionally, until at least 2018, the Company did not have adequate written policies and procedures concerning its oversight of advisory fee calculations and related fee waivers. The Company has since disbursed to investors the $27 million in fees that should have been waived, plus interest and a performance adjustment. In the action concerning the first fund, the SEC's order found that the Company violated Section 206(4) of the Advisers Act and Rule 206(4)-8 and Section 34(b) of the Investment Company Act. In the action concerning the second fund, the SEC's order found that the Company violated Section 206(4) of the Advisers Act and Rule 206(4)-7. Without admitting or denying the SEC's findings, the Company agreed to a cease-and-desist order and a censure in each action and to pay a combined $9 million penalty.

SEC Settles Charges against Registered Investment Adviser over $1 Billion Fraud Allegations

The SEC filed a settled action against registered investment adviser, Infinity Q Capital Management, LLC ("Infinity Q"), for mispricing the net asset value ("NAV") of its public mutual fund and private fund as part of what the SEC referred to as a "massive overvaluation scheme." The SEC's June 16, 2023, complaint (the "Complaint") sought an order appointing a monitor to oversee the return of remaining funds to harmed private fund investors. The SEC previously charged the mutual fund with mispricing its NAV, and the court appointed a special master to oversee the distribution of the mutual fund's remaining funds to its harmed investors. According to the SEC's Complaint, from at least February 2017 through February 2021, the mutual fund's and hedge fund's reported NAVs were materially and falsely inflated due to a fraudulent mismarking scheme conducted by Infinity Q through its Chief Investment Officer, James Velissaris. Infinity Q represented to investors and others that certain holdings of the Infinity Q Funds were valued by an independent third-party pricing service when Infinity Q in fact was actively manipulating the valuation models available from the pricing service and altering inputs to mask the poor performance of the funds. The SEC previously charged Velissaris for his role in the scheme.

The SEC's Complaint, filed in the U.S. District Court for the Southern District of New York, charged Infinity Q with violating the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; the antifraud, books and records, and reporting provisions of Sections 204(a), 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(a), 206(4)-7, and 206(4)-8 thereunder; and the reporting provisions of Section 34(b) of the Investment Company Act. It also charges Infinity Q with aiding and abetting its mutual fund's violation of the pricing provisions of Rule 22c-1 under the Investment Company Act. Infinity Q has agreed to settle the charges and consented to the appointment of the monitor. The settlement, which permanently enjoins Infinity Q from violating the federal securities laws charged in the Complaint, and the appointment of the monitor, are subject to court approval.

SEC Charges Private Equity Fund Adviser for Overcharging Fees and Failing to Disclose Fee Calculation Conflict

The SEC charged New York-based investment adviser Insight Venture Management LLC ("Insight") with charging excess management fees and failing to disclose a conflict of interest to investors relating to its fee calculations. According to the SEC's order, issued on June 20, 2023, Insight's limited partnership agreements for certain funds it advised allowed it to charge management fees based on the funds' invested capital in individual portfolio investments and required Insight to reduce the basis for these fees if Insight determined that one of these portfolio investments had suffered a permanent impairment. The order found that, from August 2017 through April 2021, Insight charged excess management fees by inaccurately calculating management fees based on aggregated invested capital at the portfolio company level instead of at the individual portfolio investment security level, as required by the applicable limited partnership agreements.

Further, the SEC's order found that Insight failed to disclose to investors a conflict of interest in connection with its permanent impairment criteria and because of this, investors were unaware that the criteria Insight used were narrow and subjective, making them difficult to satisfy. Therefore, the order found that Insight's investors were unaware that Insight's permanent impairment criteria granted Insight significant latitude to determine whether an asset would be considered permanently impaired so as to reduce the basis used to calculate Insight's management fees. Insight consented to the entry of the SEC's order finding that the firm violated Sections 206(2) and 206(4) of the Investment Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. Without admitting or denying the SEC's findings, Insight agreed to a cease-and-desist order and censure and to pay a $1.5 million penalty and $864,958 in disgorgement and prejudgment interest, which has already been paid back to the impacted funds. The SEC's order deemed the disgorgement and prejudgment interest satisfied by Insight's payment back to the impacted funds last month.

For additional information and assistance, contact Thomas R. Westle, Stacy H. Louizos, or another member of Blank Rome's Investment Management Group.

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